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1255 TWENTY-THIRD STREET

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

LEONARD JERVEY KENNEDY

DIRECT DIAL NO.

857-2505

September 27, 1994

TELEPHONE (202) 857-2500

FACSIMILE (202) 857-2900

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

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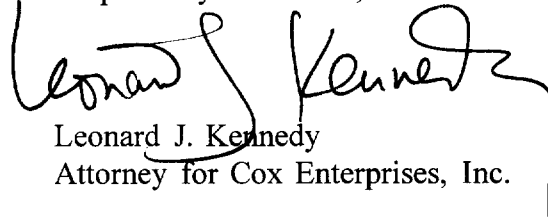
Re: Ex Parte Meeting ⁹²⁻
MM Docket No. 29-266

Dear Mr. Caton:

On behalf of Cox Enterprises, Inc. and pursuant to Section 1.1206(a) of the Commission's Rules, this letter will constitute notice that on Monday, September 26, 1994, Alexander V. Netchvolodoff, Vice President Government Affairs of Cox Enterprises, Inc. and the undersigned met with Kathy Wallman, Deputy Chief Cable Services Bureau and Edward Hearst, Esq., Cable Services Bureau to discuss outstanding issues in the above-referenced docket, including the introduction of new services. Cox's views on the substantive issues discussed are set forth in the attached submission.

Should any questions arise in connection with this notification, please do not hesitate to contact the undersigned.

Respectfully submitted,


Leonard J. Kennedy
Attorney for Cox Enterprises, Inc.

LJK/rlf
Attachment

cc (w/attachment): Alexander V. Netchvolodoff
Kathy Wallman
Edward Hearst, Esq.

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**COX ENTERPRISES, INC.
POSITION PAPER ON FCC CABLE "GOING FORWARD" PROPOSALS**

Cox Enterprises, Inc., through its subsidiary Cox Cable Communications, Inc., serves roughly 1.8 million cable subscribers nationwide. It commends the Commission for its continued hard work and willingness to solicit industry input on the cable "going forward" issues. This position paper briefly explains Cox's analysis of the proposals being considered by the Commission in this area.

Formula for Adding Channels to Regulated Tiers

Flat Fee Mark-Up. Cox supports a going forward formula that would allow cable operators to increase rates by the program license fee, plus a mark-up of 25 cents, when a channel is added to a regulated service tier. This approach is administratively simple for the programmer, the operator and local and federal regulators. It also provides the operator with sufficient incentive to add new regulated program services which, in turn, will encourage new programming.

The record in the going forward proceeding contains two economic analyses (one by Stan Besen and one by Bruce Owens) supporting a mark-up of 25 cents. These analyses have not, to Cox's knowledge, been discredited by other commenters. In addition, Cox's own analysis reveals that a 25 cent mark-up is on the low end of the amount needed to cover an operator's investment risk and non-programming costs when it adds a new program service. (See Attachment A.)

Annual Cap. Cox's experience with operating cable systems demonstrates that market forces impose a very real limit on the amount by which a system can raise rates in a given year. The launch of Direct TV and other DBS services and the millions of dollars spent promoting these services has imposed a real restraint on cable's pricing, even though penetration has not reached the statutory effective competition threshold of 15 percent. It therefore does not object to the proposal to impose an annual cap of \$1.50 on rate increases caused by the addition of channels to regulated tiers. Cox also believes that operators should be permitted to add more channels than the cap would otherwise allow in one year, and then use part of the next year's annual cap to recover its losses. This "carry forward" proposal (which is explained in more detail in Attachment B) would help ameliorate what would otherwise be a regulatory disincentive to add a number of new channels in one year (for example, due to an upgrade), even if that is what the operator and its subscribers would like to do.

Although it accepts the concept of an annual cap, Cox opposes the proposal to regulate how much of the cap could be used for the mark-up and how much could be

used for program license fees. Besides adding an unnecessary layer of administrative complexity, this "sub-cap" approach would undermine the operator's ability and incentive to bargain with programmers to keep program license fees low. If the programmer knew that the cable operator had 75 cents to spend on programming costs and would only be able to add three channels at a 25 cent mark-up each before reaching the mark-up sub-cap, the programmer would seek to maximize its rates and obtain as much of the 75 cents allocated to programming costs as possible. Any attempt by the operator to negotiate lower rates would be met with the response, "You can pass it on to the subscribers." It was a similar concern that led the Commission to prohibit the pass through of retransmission consent fees in the initial year. The sub-cap proposal also would limit artificially the number of channels that an operator could add in one year. That is, if only 75 cents of the \$1.50 annual cap could be used for the mark-up component, an operator would be unlikely to add more than 3 channels ($3 \times \$0.25 = \0.75) in one year (assuming a 25 cents per channel mark up). The result is that the operator would add three high cost channels.

Cox appreciates the Commission's concern that operators not be given an incentive to add lots of low-quality, low-cost channels to regulated tiers. It would note, however, that many high-quality channels, when newly launched, are also low-cost. For example, The Learning Channel, The Travel Channel, Court TV, C-SPAN, C-SPAN II, Telemundo and SciFi Channel, among others, have rates of 10 cents per subscriber or less. Thus, the sub-cap approach would prevent an operator from adding more than three high-quality, yet low-cost, channels in one year, even if that is what subscribers or competitive necessity demands. The potential for such an adverse result outweighs the concern that a few operators may seek to manipulate the annual cap in a way that does not serve subscriber needs.

Safe Harbor/ "Forbearance"

Cox understands that the Commission is considering a proposal that would apply a different rate standard to new program services if the operator agrees to preserve its current regulated offerings. Under one variation of this proposal, an operator that continued to offer subscribers its current regulated tiers (i.e., "preserved its regulated architecture") would be able to add new tiers of new program services (not available on an a la carte basis) and not have the rates for those tiers regulated (at least for the time being).¹ There would be some limited exceptions to "preserving the regulated architecture" -- for example, an operator could drop a channel from an existing tier, move a channel to pure a la carte status, and even "migrate" a channel to one of the new service tiers in certain circumstances without leaving the safe harbor. Presumably, however, if the operator did more to rearrange its regulated offerings, the new service tiers would then

¹ Cox has heard this proposal described as a "forbearance" policy, pursuant to which the Commission would assert jurisdiction but "forbear" from regulating the rates for these new service tiers as long as the stated conditions were met. It believes, however, that such a policy rests on shaky legal grounds.

become subject to rate regulation under the Commission's benchmark/cost-of-service rules.

While this aspect of the proposal seems to parallel the "experimental upgrade" proposal set forth in the Commission's February 22, 1994 cost-of-service order, the proposal does seem to penalize operators for experimenting with their regulated offerings, even in response to consumer and/or competitive demands. By doing so, operators may lose the protection of the safe harbor. Having said this, however, Cox recognizes that the Commission could regulate the rates for such new service tiers in any event, and that this part of the proposal thus would give operators new flexibility they did not previously enjoy.

Cox strongly opposes a variation of the proposal that would bring a la carte packages, for the first time, under the Commission's regulatory umbrella, and then include them in the safe harbor as new regulated tiers. The Commission has twice found that packages of a la carte channels are not regulated service tiers, so long as certain conditions are met.² This determination was based not only on a legal analysis which demonstrated that a la carte packages are not subject to rate regulation, but also on the Commission's assessment that, in the absence of evasive behavior, not regulating such packages best serves the public interest. Specifically, the Commission found in its April 1, 1993 Rate Order that:

Operator has an election

- Market forces, rather than regulation, will ensure that the rates for a la carte channels are reasonable. It thus follows logically that, if the rates for individual a la carte channels are reasonable, the rate for a package comprised of those channels must be reasonable as long as the package price does not exceed the sum of the rates for the individual channels.
- A properly structured a la carte package (that is, a package that offers a realistic choice between the individual channels and the package itself) enhances subscriber choice by allowing consumers to choose only those program services they wish to see, and not requiring them to pay for programs they do not desire.
- If a la carte packages are regulated, operators will likely refrain from combining premium services into integrated packages, thereby depriving consumers of both rate discounts and greater access to a la carte services.³

These findings were upheld on reconsideration, although the Commission did take the opportunity to specify more precisely the circumstances under which creation of an a la carte package would be viewed as an evasion.

² The conclusion that a la carte packages are not regulated services is codified at Section 76.986 of the Commission's Rules.

³ See discussion at paras. 326-9, First Report and Order on Rate Regulation, 8 FCC Red 5836-38 (1993.)

Cox has long offered premium channels (such as HBO and Showtime) in discounted packages, and believes that its ability to continue doing so must be preserved for its subscribers' sake. In addition, as the 500-channel world unfolds, Cox must have the flexibility to jointly market and discount the a la carte channels that will serve as the video library of the future.⁴ As the Commission previously has concluded, a policy that automatically views these packages as regulated tiers -- and ties their price tags to rates in effect in October 1992 when the envisioned a la carte world did not yet exist -- will only disserve subscribers by depriving them of options and discounts they would otherwise enjoy.

Cox thus urges the Commission not to change course and repeal its a la carte rule by finding that a la carte packages are, in fact, cable programming service tiers⁵ to which a "forbearance" policy would apply.⁶ Rather, the Commission should attack the underlying problem directly by instituting a strong enforcement policy aimed at preventing operators from using a la carte packages to evade rate regulation. In addition, the Commission should continue its work on developing more specific guidance for operators to help them determine which types of a la carte packages may be found to be rate evasions. In this latter regard, Cox is willing to provide whatever assistance it can to help the Commission draw this important distinction.

⁴ Consumers undoubtedly will demand some form of packaging, if only to help them figure out which channels are available.

⁵ 47 USC § 543(l)(2) defines cable programming service as "any video programming provided over a cable system, ...other than...(B) video programming offered on a per channel or per program basis". Only programming on the basic and cable programming service tiers can be rate regulated, and Cox believes that if programming in an a la carte package is offered on a per channel or per program basis, the Commission does not have the legal authority to regulate the rates of such package.

⁶ As noted above, Cox is concerned about the legality and practicality of a forbearance policy. Moreover, it does not appear that the Commission could change the regulated status of a la carte packages and then subject them to a forbearance policy without further rulemaking, since a change to Section 76.986 of the Commission's Rules clearly seems involved and there has been no official notice of, or comment on, that change. Cox also is unaware of any change in circumstances that has occurred since February, 1994, when the Commission last considered the regulatory status of a la carte packages.

ATTACHMENT A

Value of an Additional Channel

In trying to determine the mark-up needed to cover an operator's investment risk and non-programming costs when adding new programming to regulated tiers, Cox decided that a logical starting point would be the Commission's own formula for determining a competitive rate for channels. Based on the assumption that the rates for regulated services derived by using Form 1200 are fair and reasonable, Cox computed a per-channel rate for each system. (See attached chart.) It then subtracted all external costs (franchise fees, copyright fees and total programming costs) from the per-channel rate. The last column of the chart shows the maximum permitted rate per channel (weighted average of basic and CPS) calculated using Form 1200, excluding external costs. In every Cox system, the remaining rate exceeds 25 cents and runs as high as 53 cents. Even giving weight to an efficiency discount achieved as more channels are added, this analysis indicates that a 25 cents mark up would be on the extreme low end.

Cox Cable Communications
Maximum Permitted Rates Per Channel

		Max. Permitted/Retail Price/Month			Channels			Max. Permitted Per Channel			Max. Permitted Rate Per Channel (Excl. External Costs) *		
		Basic	CPS	TOTAL	Basic	CPS	TOTAL	Basic	CPS	TOTAL	Basic	CPS	TOTAL
San Diego	S.D. 650MH	8.02	17.14	25.16	18	37	55	0.45	0.46	0.46	0.42	0.34	0.36
Hartford	HARTFORD	7.59	13.81	21.40	19	32	51	0.40	0.43	0.42	0.36	0.27	0.30
Spokane	SPOKANE	5.55	16.24	21.79	14	37	51	0.40	0.44	0.43	0.39	0.33	0.34
Santa Barbara	SANTA BARBARA	15.34	7.53	22.87	33	16	49	0.46	0.47	0.47	0.30	0.29	0.30
	CARPENTERIA	15.29	7.51	22.80	33	16	49	0.46	0.47	0.47	0.30	0.29	0.29
	SANTA BARBARA CTY	15.36	7.52	22.88	33	16	49	0.47	0.47	0.47	0.30	0.29	0.29
Hampton Roads	NORFOLK	7.37	13.18	20.53	18	31	49	0.41	0.42	0.42	0.30	0.29	0.29
	PORTSMOUTH	7.45	13.30	20.75	18	31	49	0.41	0.43	0.42	0.30	0.29	0.30
	FORT STORY	7.85	13.67	21.32	18	31	49	0.43	0.44	0.44	0.41	0.31	0.35
	NAVAL BASES	7.28	13.04	20.32	18	31	49	0.40	0.42	0.41	0.39	0.29	0.32
	CHESAPEAKE	7.61	13.60	21.21	18	31	49	0.42	0.44	0.43	0.41	0.30	0.34
	VIRGINIA BCH	7.83	13.59	21.22	18	31	49	0.42	0.44	0.43	0.31	0.30	0.31
	CURRITUCK COUNTY	7.68	13.70	21.38	18	31	49	0.43	0.44	0.44	0.28	0.31	0.30
	OKC - UPGRADE	4.95	16.02	20.97	12	37	49	0.41	0.43	0.43	0.32	0.32	0.32
OKC	OKC - NONUPGRADE	6.22	13.17	19.39	12	24	36	0.52	0.55	0.54	0.42	0.40	0.40
	RHODE ISLAND	8.42	13.24	21.66	19	29	48	0.44	0.46	0.45	0.41	0.32	0.36
Rhode Island	OMAHA	10.28	11.07	21.35	24	24	48	0.43	0.46	0.44	0.41	0.28	0.35
Omaha	MYRTLE BEACH	7.24	13.91	21.15	15	29	44	0.48	0.48	0.48	0.44	0.39	0.40
Myrtle Beach	ATLANTIC BCH	7.38	14.45	21.83	15	29	44	0.49	0.50	0.50	0.45	0.37	0.40
	BRIARCLIFFE ACRES	7.42	14.67	22.09	15	29	44	0.49	0.51	0.50	0.46	0.37	0.40
Saginaw	HORRY CTY	6.87	13.17	20.04	15	29	44	0.46	0.46	0.46	0.41	0.37	0.39
	N. MYRTLE BCH	6.76	13.05	19.81	15	29	44	0.45	0.45	0.45	0.41	0.36	0.38
	CONWAY	7.10	14.01	21.11	15	29	44	0.47	0.48	0.48	0.44	0.35	0.38
	SAGINAW	8.41	10.81	19.22	19	23	42	0.44	0.47	0.46	0.41	0.32	0.36
	SAGINAW TWSP	8.51	10.94	19.45	19	23	42	0.45	0.48	0.46	0.42	0.32	0.37
	ZILWAUKEE	8.38	10.77	19.15	19	23	42	0.44	0.47	0.46	0.41	0.31	0.36
	CARROLLTON TWSP	8.34	10.73	19.07	19	23	42	0.44	0.47	0.45	0.41	0.31	0.36
	BUENA VISTA TWSP	8.68	11.13	19.81	19	23	42	0.46	0.48	0.47	0.43	0.33	0.37
Quad Cities	SPAULDING TWSP	8.68	11.14	19.82	19	23	42	0.46	0.48	0.47	0.43	0.33	0.37
	KOCHVILLE TWSP	8.31	10.69	19.00	19	23	42	0.44	0.46	0.45	0.41	0.31	0.36
	BRIDGEPORT TWSP	8.77	11.25	20.02	19	23	42	0.46	0.49	0.48	0.43	0.33	0.38
	QUAD CITIES	9.90	11.63	21.53	20	22	42	0.50	0.53	0.51	0.46	0.37	0.41
	PENSACOLA	8.28	11.51	19.79	17	23	40	0.49	0.50	0.49	0.47	0.33	0.38
	ESCAMBIA CTY	8.28	11.50	19.76	17	23	40	0.49	0.50	0.49	0.47	0.33	0.38
	LUBBOCK	10.69	11.48	22.17	18	19	37	0.59	0.60	0.60	0.45	0.44	0.44
	EUREKA	6.84	13.65	20.29	12	24	36	0.55	0.57	0.56	0.43	0.39	0.44
Humboldt	HUMBOLDT CTY	6.85	13.67	20.32	12	24	36	0.55	0.57	0.56	0.43	0.39	0.44
	FORTUNA	6.57	13.53	20.10	12	24	36	0.55	0.56	0.56	0.43	0.39	0.44
	RIO DELL	6.60	13.58	20.18	12	24	36	0.55	0.57	0.56	0.43	0.39	0.44
	EUREKA-UNREGULATED	6.55	13.49	20.04	12	24	36	0.55	0.56	0.56	0.42	0.39	0.44
	ROANOKE	7.68	12.67	20.35	13	21	34	0.59	0.60	0.60	0.57	0.43	0.44
	ROANOKE CTY	7.91	13.02	20.93	13	21	34	0.61	0.62	0.62	0.59	0.44	0.45
	VINTON	7.90	13.01	20.91	13	21	34	0.61	0.62	0.62	0.59	0.44	0.45
	OCALA	6.67	11.95	18.62	12	20	32	0.56	0.60	0.58	0.55	0.39	0.40
Gainesville/Ocala	GAINESVILLE	7.45	14.41	21.86	11	21	32	0.68	0.69	0.68	0.57	0.48	0.50
	MARION CTY	6.69	11.92	18.61	12	20	32	0.56	0.60	0.58	0.55	0.39	0.40
	ALACHUA CTY	7.43	14.35	21.78	11	21	32	0.68	0.68	0.68	0.62	0.48	0.50
Cedar Rapids	CEDAR RAPIDS	7.18	12.43	19.61	12	20	32	0.60	0.62	0.61	0.57	0.45	0.46

* External Costs include Franchise, Copyright and Programming Costs

ATTACHMENT B

Carry Forward Proposal

This proposal would allow cable operators to add more channels than would be economically realistic under the proposed annual cap for adding program services to regulated tiers, to the benefit of subscribers. Simply put, the operator should be allowed to recover mark-ups in excess of the annual cap in succeeding years, similar to a "loss carry forward" under the IRC. For example, assume a per-channel mark-up of 25 cents, an annual cap of \$1.50 and no "sub cap" on mark-ups for programming added to a regulated tier. Further assume that the operator desires to add 10 channels with a total cost of programming of \$1.00 in Year One. The \$1.50 cap would allow the operator a mark-up of only 50 cents for the additional 10 channels, even though the permitted per-channel mark-up would be \$2.50. Cox proposes that the operator should be allowed to take the "excess" mark-up in succeeding years until the full mark-up (plus time value of money) is recovered, as long as the \$1.50 cap is not exceeded in any one year. In effect, this would be a "loan" of additional programming to subscribers which is "repaid" in future years. This proposal would give operators greater incentive to add a number of channels in one year (due, for example, to an upgrade), while at the same time avoiding rate shock for consumers.